The Real Estate ANALYST

JUNE 18
1957

MORTGAGE BULLETIN

Volume XXVI

Number 24

Real Estate Economists, Appraisers and Counselors

THE HOUSING ACT OF 1957 – A WARNING FOR LENDERS

BY virtually any yardstick, the Housing Act of 1957 (which now is in the final stages of the lawmaking process) is a noteworthy piece of legislation. It is remarkable in at least three respects: for what it omits; for what it provides; and for what it promises to lead to in the future. On all counts it deserves the closest scrutiny by mortgage lenders.

For the first time within memory, the new housing measure fails to call for a further increase in the general mortgage insurance authorization of FHA. The reason: owing to the reduced rate of its activities in the past 12 months; the agency simply doesn't need one. As of December 31, 1956, FHA had on its books nearly \$3.1 billion of unused authority, enough to last through the fiscal year of 1958. By the same token, both chambers this year refused to approve any new public housing units. Furthermore, they rejected the proposal to tap the National Service Life Insurance Fund, in order to assist the mortgage market.

These omissions - notably the last two - might suggest at first glance that Congress, in terms of housing and home finance, finally had "got religion." Actually, nothing could be further from the truth. Indeed, in the view of some astute observers of the mortgage market, the Housing Act of 1957, particularly in today's economic setting, is unsound, inflationary and blatantly hostile to private lending.

In brief summary, its main provisions: lower effective interest rates, instead of raising them; reduce downpayments, raise maximum mortgage amounts and extend maturities on various FHA programs; channel more of the taxpayer's money into direct lending; and, perhaps most distressing of all, make a fresh attempt to place a Federal ceiling on the price of mortgage money.

Let us analyze the various provisions more closely. As to interest rates, qualified witnesses at the hearings were unanimous in the view that the best way to spur homebuilding today is to raise from $4\frac{1}{2}\%$ to 5% the interest rate on loans guaranteed by the Veterans Administration. Congress, however, would not agree. Not only did it flatly reject a hike in the VA rate, but also, following a precedent set a year ago, it chose to vote for lower interest charges. In 1956, it will be recalled, in extending Title I (home modernization and improvement loans), the lawmakers set a 5% ceiling on discounts on amounts up to \$2,500 (and 4% on everything above that figure). This year they have pushed their philosophy of cheap money into other corners of FHA.

Thus the House has passed a bill which would compel the Federal National Mortgage Association to acquire all special assistance liens at par rather than at 99. The Senate, in turn, has voted to limit all FNMA fees and charges to not over 1% of the face value of the mortgage. It also would lower the rate covering Section 221 loans from a ceiling of 6% (and a prevailing 5%) to no more than 4%. Whether or not such changes remain in the final version of the law - which was still in conference committee at this writing - remains to be seen. Nonetheless, they clearly indicate a deep, and apparently mounting, prejudice on Capitol Hill against the free workings of the money market.

Plenty of other evidence to the same effect may be cited. During the heated three-day debate in the Upper Chamber, to illustrate, one Senator introduced an amendment - described by another as "the most preposterous proposal that has ever come from the other side of the aisle" - which would have compelled FNMA to buy $3 billion worth of FHA and VA home loans at par. The amendment, which also would have banned all discounts on U. S.-insured or guaranteed mortgages, won 17 yea votes (against 61 nays) on a roll call.

Moreover, despite this defeat, both houses passed bills which call for some attempt to limit discounts (the House version directs the HHFA to make a study and submit the recommendations on the subject by next April 30). Similar efforts, of course, made a few years ago, led only to widespread evasion and failure. Most of the lawmakers conceded that any new attempt to prohibit discounting outright would meet with the same fate. On the other hand, despite all logic, they felt that somehow the housing agencies would be more successful in keeping discounts to a "reasonable" figure. In any case, they are determined to try. Sooner or later, in short, the housing and home finance industries will be saddled with a regulation which, in the blunt words of one official, "would require the wisdom of a Solomon to administer."

The forthcoming legislation also calls for a good many changes, large and small alike, in the terms of various FHA programs. Section 213 - covering mortgage loans secured by cooperative housing projects - is a case in point. Congress for years has been trying to spur this kind of project. The Housing Act of 1956 lowered downpayments under this program from 10% to 5% for groups with a veteran membership of 50% (instead of 65% as previously). For the first time it also approved FHA insurance up to 85% of replacement cost on projects launched by a corporate investor who certified his intention of selling them to a cooperative group within two years after completion.

This year Congress has been even more generous. For one thing, in March it authorized FNMA to step up its purchases of such mortgages from $50 million to $100 million. Moreover, under the new Housing Act such authority will be boosted still more - by $200 million, in fact, under the Senate version. In addition, the latter authorizes Section 213 coverage for existing structures as well as new ones. In such cases, says the Senate, the mortgage amount should be based upon FHA's estimate of value, rather than replacement cost, as is true of new construction.

At the same time, it has hinted broadly that such estimates should be generous. Said the report of the Committee on Banking and Currency: "The value determination should take account of the fact that the property is purchased as a cooperative for continued use and occupancy, rather than as an income-producing investment. Therefore, the usual technique used in the valuation of rental properties should be modified accordingly."

Regarding Section 203, which is FHA's basic sales housing program, downpayments will be cut to a new low. As enacted by the House, the bill calls for loan-to-value ratios of 97% of the first $10,000 of appraised value, 85% of the next $6,000, and 70% of everything over that amount. The Senate version, which differs slightly, calls for ratios of 97%, 90%, and 70%. Either way, downpayments will be lowered sharply.

For example, a home appraised by FHA at $12,000 today requires a downpayment of $1,200. Under the measures passed by House and Senate, the figure would be whittled to $600 and $500, respectively. On a $20,000 house, the downpayment would be reduced from $3,200 to $2,400-$2,100. Such changes, to be sure, will stimulate demand. However, in today's market, when top-flight utilities are paying around 4-3/4% to borrow, they are unlikely to increase the supply of loanable funds.

Another program, Section 221, points up even more sharply just how far and how fast Congress has been traveling away from sound lending principles. In the Housing Act of 1954, it will be recalled, the attempt first was made to provide 100%-of-value, 40-year mortgages on housing for families displaced by local slum clearance. The proposals, which evoked sharp and effective criticism at the time, were defeated. Last year, however, both were written into law.

Now the Senate proposes to go still further. It would broaden the coverage of Section 221 to include, besides citizens affected by urban renewal activities, such groups as persons of moderate income (defined as an individual who is unable to rent new privately financed housing for 20% of his available income); people who cannot obtain adequate living quarters because of race, creed or color; or people with five or more dependents. The Upper Chamber also would increase the maximum mortgage limit from $9,000 to $12,500 per unit and from $10,000 to $15,000 in high-cost areas. Finally, as noted above, the interest rate on Section 221 loans would be reduced to 4%. To make this rate effective, Fannie Mae, through its special assistance function, would be authorized to buy $75 million of such mortgages (whittled down sharply on the floor of the Senate from an original $250 million).

Dollar-wise, the major provisions of the Housing Act of 1957 concern FNMA. Whatever may happen in conference committee, the agency is assured of winding up with an increase of at least $50 million and perhaps as much as $125 million in new preferred stock, capable of supporting a tenfold expansion in its mortgage acquisitions in the secondary market. (The additional preferred, which is held by the

Treasury, also makes still more remote the day when FNMA will be owned and operated by its common shareholders.)

In addition, the pending measure makes one or two technical changes in the operation. It sets a maximum of 2% on the amount of stock which those who use the agency's facilities must purchase. It also allows FNMA, in computing the amount which must be paid in lieu of taxes to the Treasury, to deduct dividends on the preferred stock held by the latter.

Most significant of all, the new Act will lead to a spurt in the agency's special assistance purchases. For such activities - including loans on military housing under Title VIII - the Senate has voted an additional $475 million, the House nearly as much. Back in 1954, when Congress was mulling over ways and means of reconstituting Fannie Mae, William A. Clarke, then president of the Mortgage Bankers Association, sharply opposed the special assistance functions. "We think it is neither necessary nor desirable for the Government to keep such a financial bomb in its closet," he observed. Now, obviously, the bomb is about to be exploded.

The obvious intent of both chambers - against the better judgment of FNMA and its canny Administrator, J. Stanley Baughman - is to force the agency into more vigorous support of special assistance housing. On that score, it's worth noting that by doling out funds conservatively, and only at a discount, FNMA has left room for nongovernment sources to participate in the assistance programs. Thus, for example, as of January 31, 1957, nearly 30% of all outstanding Section 221 mortgages and more than half of all Section 220 loans had been placed privately. Plainly, the intent of Congress is to make it more difficult for investors to participate.

Summing up, it is hard to find a good word for the Housing Act of 1957. It fails to do the one simple thing - raising the VA rate - which would effectively stimulate the flow of money into home loans. Instead, it serves up a dubious potpourri of direct Government loans and easier, cheaper credit terms which seem designed to discourage, rather than encourage, private lending.

Finally, and this is surely worth noting, the current measure is viewed by its supporters as merely a warm-up for its successor. Next year, to judge by all the signs and portents, powerful forces in Congress will make a determined effort to enact not merely an expanded program of public housing, but a big new subsidy scheme for middle-income groups as well. For those who believe that home finance is a job for private enterprise, and not for Government, 1958 may well be a decisive year.